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SENSITIVE

DEPT PLEASE PASS TO MCC CEO APPLLEGARTH FROM AMBASSADOR
LUNSTEAD; DEPT FOR SA/INS J.BRENNIG/N.DEAN; TREASURY FOR
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SUBJECT: SCENESETTER FOR VISIT OF MCC CEO PAUL APPLLEGARTH

1. (SBU) Summary: MCC CEO Applegarth's visit comes as Sri Lanka begins the post-Tsunami transition from relief to reconstruction. With ample public and private funds available for tsunami reconstruction, the Government of Sri Lanka (GSL) and the Embassy see MCA funding as an opportunity to address the longstanding needs of areas not affected by the tsunami. However, the GSL's ability to usher in a collaborative process, effectively coordinate among diverse interests and implement in a timely and transparent manner are issues to address during your visit. The Government has begun to increase private sector participation in the consultative process, but needs to widen the scope of involvement by NGOs and civil society. The Government has requested assistance from The Asian Foundation to bolster this effort. Your visit provides an opportunity to encourage the GSL to revitalize the consultative process so that a focused, comprehensive compact proposal will be produced soon. End Summary.

2. (U) Post welcomes the late March visit by Millennium Challenge Corporation (MCC) CEO Paul Applegarth. Your visit comes as the country wraps up the immediate post-tsunami relief phase and begins to focus on rebuilding

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affected areas, and resuming work in non-affected areas.

Effect of the Asian Tsunami

3. (U) The tsunami, which has garnered almost all the attention paid to Sri Lanka in recent months, was a unique disaster. The affected area spanned almost 700 miles of coastline, but, except for a few isolated areas, reached no more than 500 meters inland. Therefore, the main areas of population and economic growth, the Western and Central provinces, were largely untouched.

Inequitable Distribution of Assistance

4. (U) There are increasingly vocal concerns about inequity in the post-tsunami assistance, relief and rebuilding processes, especially for those areas of the country beset by decades of civil war. Thousands of families displaced by war are still living in shelter/camp arrangements. As literally billions of dollars have been promised for tsunami rebuilding, many of the people affected by the no less devastating civil war are feeling marginalized. This is not the fault of the GSL, but the effect of restricted public and private donations narrowly earmarked for tsunami relief.

5. (U) The Government has indicated that it intends to focus its MCA proposals on pre-tsunami priorities. Post agrees that this would be preferable to adding more money to the post-tsunami effort, which the World Bank Resident Representative has warned is at risk of being "over-financed."

6. (U) Regarding the effects of the tsunami, the numbers show that it remains a primarily human tragedy. While over 40,000 were killed, the IMF has predicted that Sri Lanka will likely see a .5 to 1 percentage point drop in GDP, and the Sri Lankan Central Bank is predicting at most a half percentage point drop (Maldives, by comparison, saw its damage total almost 60 percent of GDP and GDP growth is forecast to drop from a projected 8.5 percent to just 1 percent in 2005).

7. (SBU) Of larger concern than the actual macro-economic impacts of the disaster are the challenges to the assistance and reconstruction process caused by poor coordination among GSL agencies, a lack of consultations in post-tsunami decision-making and a Government tendency to retreat behind the bulwarks of its bureaucracy. While these challenges are being addressed, progress is proceeding at a measured pace.

Political Situation

18. (SBU) The Sri Lankan Government is headed by President Chandrika Kumaratunga, whose Sri Lankan Freedom Party heads an eclectic coalition, including the Marxist/nationalist Janatha Vimukthi Peramuna (JVP) party, which has turned from a violent past and become an increasingly important, if not always constructive, political player. Former Prime Minister Ranil Wickremesinghe of the United National Party heads the main opposition.

19. (U) The UNP was soundly defeated in elections in April 2004, following two years in power where it instigated market-oriented policy reforms that helped achieve long-elusive macroeconomic stability. Such stability, however, had still not translated into improvements in the lives of the rural poor, and most growth was concentrated in the Western province, around Colombo. The UNP's electoral defeat was largely at the hands of dissatisfied rural voters.

The Peace Process

10. (U) The peace process between the Government and the Liberation Tigers of Tamil Eelam continues. The cease-fire has now been in effect for more than three years, but the peace negotiations have been stalled for almost two years, following the LTTE walkout of talks in April 2003. The GSL is currently engaged in efforts, brokered by the Norwegians, with the LTTE to develop a joint mechanism for tsunami assistance in the north and east.

The MCA Process

11. (SBU) MCA's requirements for a broad-based consultative process are proving the highest hurdle to progress on the GSL's compact proposal. The GSL position is that Sri Lanka is different from many of the other MCA eligible countries. It believes its democratic traditions and institutions are stronger and more developed, therefore implying a consultative mechanism that is built directly into their system. In other words, the governance model in Sri Lanka, of a central government whose reach extends down to every village through a network of provincial governments, district secretaries and village-level bodies, guarantees that the

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needs of the people are well consulted and widely known.

12. (SBU) While this network exists, its efficacy is debatable (Note: were the village and provincial Governments so effective, many of the post-tsunami relief and reconstruction problems would not exist. End Note). Sri Lanka's concept paper was a collection of projects to address economic needs that are well known and widely agreed (i.e. rural roads, power and energy, small and medium sized business development, irrigation and agriculture sector infrastructure, etc.). However, it did not include many of the key points necessary for successful conclusion of a compact, including an identification and prioritization of projects to overcome impediments to growth, an analysis of how the proposed projects would overcome those obstacles, and the kinds of policy reforms that would clear the way for efficient implementation of the proposed solutions.

13. (SBU) As the process has moved forward, we have been pleasantly surprised to see a much wider inclusion of the business community in the process, but we continue to advocate for wider NGO and civil society involvement. The GSL has asked The Asia Foundation and the American Chamber of Commerce to assist in broadening the consultative mechanism. The Asia Foundation is interested in helping, but is wary that it not be viewed as some sort of "rainmaker" able to "deliver" MCA money.

Comment

14. (SBU) Your visit is an opportunity to gauge whether sufficient changes are being instituted as a result of the most recent MCC delegation visit in February. Some progress has been made (e.g. the invitations to Asia Foundation and Amcham to be involved in the consultative process), but the GSL is facing numerous challenges with limited capacity and we should not have unrealistic expectations about the amount of progress they could have made in the past four weeks.

15. (SBU) During your meetings, you will have the opportunity to stress two main themes:

--Sri Lanka needs to broaden and improve the consultative process as it moves toward its initial compact proposal;

--Sri Lanka should prioritize and focus the concept paper, while paying attention to how prospective projects overcome obstacles to growth, how they will be implemented and how outcomes will be measured.

16. (SBU) The GSL wants to take advantage of the MCA opportunity and appears to have taken USG concerns on board. Nonetheless, it remains to be seen if the Government will open up the process and engage in a sufficiently widespread consultative effort to improve their chances at successfully concluding a compact negotiation. End Comment.

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